LEGISLATIVE SERVICES AGENCY OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

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FISCAL IMPACT STATEMENT

LS 6632 NOTE PREPARED: Jan 5, 2009

BILL NUMBER: HB 1684 BILL AMENDED:

SUBJECT: Captive Real Estate Investment Trusts.

FIRST AUTHOR: Rep. Friend BILL STATUS: As Introduced

FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL IMPACT: State

DEDICATED FEDERAL

<u>Summary of Legislation:</u> The bill restricts the definition of "captive real estate investment trust" in current law by excluding the following entities from the 50% ownership condition: (1) A real estate investment trust that is not itself a captive real estate investment trust. (2) A qualified foreign entity. (3) An Australian property trust.

Effective Date: January 1, 2009 (retroactive).

Explanation of State Expenditures:

Explanation of State Revenues: <u>Summary</u> - The bill excludes certain entities from the definition of a captive real estate investment trust (REIT) under the Corporate Adjusted Gross Income (AGI) Tax. Under current statute, the definition of a captive REIT identifies REITs that are owned or controlled by (or captive of) a single corporation. Current statute requires a corporate taxpayer to add back amounts deducted from federal taxable income that represent dividends paid to the corporation by a captive REIT. The bill excludes from the captive REIT definition:

- (1) REITs that aren't captive REITs according to the definition in current statute;
- (2) certain foreign corporations, trusts, associations, or partnerships that, among other assets, hold real estate assets including shares or certificates of beneficial interest in a REIT; and
- (3) an Australian property trust.

The bill could potentially reduce the tax liability of corporate taxpayers that are currently subject to the addback because of ownership interests in the types of entities described above. The extent to which

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corporate taxpayers hold interests in these entities and the potential revenue loss is indeterminable. Since the definition change is effective beginning in tax year 2009, any fiscal impact could potentially commence in FY 2009 if taxpayers adjust their estimated payments. Revenue from the Corporate AGI Tax is distributed to the state General Fund.

<u>Background Information</u> - Current statute defines a captive REIT as a corporation, a trust, or an association:

- (1) that is considered a REIT for federal income tax purposes under the Internal Revenue Code (IRC);
- (2) that is not regularly traded on an established securities market; and
- (3) in which more than 50% of the voting power, beneficial interests, or shares are owned or controlled, directly or constructively, by a single C-corporation.

A REIT is a corporation, trust or association that acts as an investment agent specializing in real estate and real estate mortgages. Under the IRC a REIT, unlike an ordinary corporation, is entitled to claim a deduction for dividends paid to shareholders against their ordinary income and net capital gains. A REIT must meet certain requirements as to ownership and organization, source of income, investment of assets, and distribution of income to shareholders.

The bill excludes qualified foreign entities and Australian property trusts from the definition of a captive REIT under the addback provision. A "qualified foreign entity" is a corporation, trust, association, or partnership organized outside U. S. law that satisfies the following criteria:

- (1) At least 75% of the entity's total asset value is represented by real estate assets (including REITs), cash and cash equivalents, and U.S. government securities.
- (2) The entity is not subject to taxation on amounts distributed to its beneficial owners, or is exempt from entry level taxation.
- (3) The entity annually distributes at least 85% of its taxable income to the holders of its shares or certificates of a beneficial interest.
- (4) Not more than 10% of the voting power or the value of the entity is held directly, indirectly, or constructively by a single entity or individual, or the shares or beneficial interests of the entity are regularly traded on an established securities market.
- (5) The entity is organized in a country that has a tax treaty with the United States.

An "Australian property trust" is either of the following:

- (1) An Australian unit trust registered under the Australian Corporations Act in which the principal class of units is listed on a recognized stock exchange in Australia and is regularly traded on an established securities market.
- (2) An entity organized as a trust in which a listed Australian property trust owns or controls, directly or indirectly, at least 75% of the voting power or value of the beneficial interests or shares in the trust.

Explanation of Local Expenditures:

Explanation of Local Revenues:

<u>State Agencies Affected:</u> Department of State Revenue.

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Local Agencies Affected:

Information Sources:

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